Is Shopify (TSX:SHOP) Absurdly Overvalued Right Now?

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) recently published its third-quarter 2020 earnings report. The earnings reported provided some excellent results, proving that the e-commerce industry's boost due to the pandemic is alive and well.

The numbers it reported were well beyond expectations, which has become a norm for Shopify. However, Shopify is trading for $1,210 at writing. The stock is down by almost 15% from its valuation on October 27. This sudden decline in the stock despite positive earnings results could be a sign that Shopify is an overvalued stock.

It could be past its growth spurt

The e-commerce giant posted more than $1 billion in revenue, putting it 96% up from the same period last year. It managed to generate well beyond analyst expectations of $882 million in revenue for this period.

Shopify's subscriptions increased by almost 50%, and its merchant solutions were up 113% compared to Q3 2019. The quarterly report showed that Shopify has had yet another fantastic quarterly performance. Despite the positive performance, investors could be realizing that the past performance does not necessarily reflect on future returns for any company.

Investors are more concerned about the future of their capital invested in stocks than companies' past performance. Yes, the past performances provide a decent estimate of what investors can expect in the future, but Shopify's numbers are too good to replicate in the future.

A decline in valuation

The dropping valuation of Shopify could be a sign that investors are realizing that the stock cannot exhibit the same growth in future quarters. At its current valuation, Shopify is trading for a trailing 12-month price to earnings ratio of 60.08. It is likely that investor expectation was too high before the earnings were announced.

Investors might be too optimistic about the tech industry and Shopify. It is a worrying sign for tech investors who still want to stay invested in stocks like Shopify. If such a substantial earning season does not excite investor interest, the stock could be in for an even greater pullback in valuation.

Foolish takeaway

People were forced to stay at home due to lockdowns worldwide. The result was a growth in sales for the e-commerce industry and increasing adoption of the digital economy by businesses. The government stimulus money also improved the liquidity of many people, allowing them to purchase more than they might have been able to afford without the government funds.

With economies reopening, governments are phasing out funds. The Canada Revenue Agency (CRA) has already phased out the Canada Emergency Response Benefit (CERB) and replaced it with Employment Insurance (EI) benefits and the Canada Recovery Benefit (CRB). Gradually, both these programs will also end.

It is only speculation at this point, but the weakened economy and reduced spending power as people still struggle to find jobs could result in reduced online shopping activity.

At writing, Shopify seems to be in the middle of a pullback in its valuation. If you believe that it will climb higher after turbulence, it could be a good time to buy shares of the company.

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